Consumer Federation of America

STATEMENT OF J. ROBERT HUNTER

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BEFORE THE OVERSIGHT AND INVESTIGATIONS SUBCOMMITTEE

OF THE HOUSE FINANCIAL SERVICES COMMITTEE

ON THE TERRORISM INSURANCE MARKET

SINCE SEPTEMBER 11TH

FEBRUARY 27, 2002

Madame Chair and Members of the Subcommittee, I appreciate your invitation to testify before you today. I am the Director of Insurance for the Consumer Federation of America.[1]

You will recall that CFA was a prime supporter of legislation to back-up the insurance industry for terrorism. Indeed, I testified before two Senate Committees that I thought it was too risky to wait to see if the lack of federal back-up would produce significant economic damage to America.

But Congress failed to act. As a result, we now have some initial knowledge of how the market will respond. The problems we see in the insurance market due to the failure of Congress to enact a terrorism insurance back-up are far less than expected.

CFA Study of the Insurance Market

To reach this conclusion, CFA undertook a major study of the insurance market after January 1, 2002. A copy of that study, which was released on January 23, 2002, is attached to my testimony. Our major findings were as follows:

1. The insurance industry is wealthy and overcapitalized.

[1] CFA is a non-profit association of more than 280 organizations that, since 1968, has sought to advance the consumer interest through advocacy and education.

2. High rates are a problem for mid-sized and larger firms.
3. The larger firms are finding alternative ways to deal with the problem such as self-insurance, creation of captive insurance companies and securitization.
4. The rate problem is caused by a classic turn in the economic cycle of the industry, sped up by – but not caused by --the terrorist attacks.
5. The hard market is anticipated to be shorter than usual because of the excess capital in the insurance industry.
6. Banks are freely loaning money to the vast majority of – if not all – businesses, regardless of the terrorism insurance situation in the nation.
7. There are presently no other widespread economic problems related to the terrorism insurance situation in America.

The losses from the World Trade Center attack will be about half to three-quarters of what the insurers predicted, amounting to \$35 billion, or \$23 billion after tax considerations, according to the New York Insurance Department. While this is the largest dollar loss ever, the impact on the industry's bottom line was 7.2% of the industry's cash surplus, not much more than the 6.3% hit from Hurricane Andrew." [2]

A remarkable finding is that the insurance industry is at least as strongly capitalized as before September 11th. The capital lost to terrorism was about \$23 billion, but the new capital already booked by the industry since September 11th in anticipation of large profits from large price hikes, is over \$24 billion. To be sure, the "lost" capital and the "new" capital are not necessarily in the same insurance companies, but the industry as a whole is more strongly capitalized now than when the terrorists struck – surely a victory for capitalism over terrorism. At least six new companies have been formed. The average stock price for the seven largest insurers has increased by 4.8% since the closing stock price of September 10th, an annual rate of increase of 11.5%.[3]

This is not to say there are no problems in the market. The biggest concern is high insurance rates for businesses.

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[2] Calculated by dividing the after-tax insured loss by the beginning of year surplus of the property/casualty primary market. This overstates the impact on the primary market in that reinsurers will pay a large percentage of the after-tax loss.

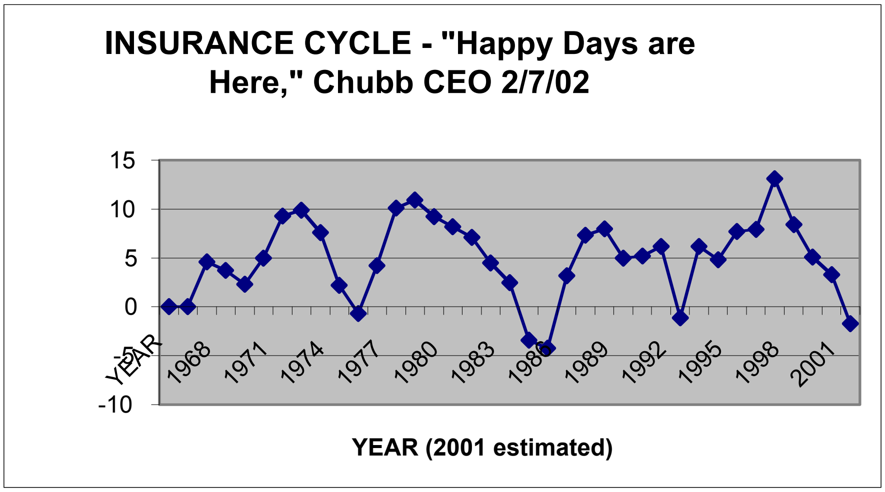
[3] Closing price as of February 15, 2002.

Over the last year, CFA's research revealed that average prices rose by about 20% for small businesses, 30% for mid-sized businesses, and 40% for large businesses. But the averages hide very high jumps in prices for some specific businesses. The worst hit are large, "terrorist target" risks, such as skyscrapers.

Some large businesses also are having difficulty getting sufficient terrorism insurance in amounts similar to the levels of previous years. Homeowner and car owner insurance appears to be fully available with only modest price increases forecast for 2002 (in the four to six percent range). Terrorism coverage for smaller commercial accounts has been excluded for many risks if insured losses from a terrorist attack exceed $25 million. However, the coverage can be bought back at a price that is manageable for most small businesses.

There appears to be little if any problem with loans in the current market for terrorism insurance. No federal bank regulator has issued any guidance on the terrorism insurance issue since they have not seen solvency problems developing from any real or perceived lack of coverage. Indeed, banks are acting as insurers of terrorism by taking risks with no terrorism coverage onto their books and charging a slightly higher interest rate in consideration of the increased risk.

The price jumps we are seeing is consistent with a classic cycle turn, accelerated by the events of September 11th but not caused by them. The chart below shows the operating income as a percentage of premium from 1967 to 2001. The operating income of the industry falls below zero four times on the chart – in 1975, in 1984 and 1985, in 1992, and in 2001 (the last number estimated by CFA).



The price increases in the hard market caused by this cycle turn began in late 2000. The rate of change was accelerating upward before September 11th. The terrorist attacks sped up the price increases into what some seasoned industry analysts see as gouging. Insurance executives have greeted the end of the hard market warmly. Mr. Dean R. O'Hare, Chubb chairman and chief executive said, "Happy days are here," at Chubb's February 7, 2002 conference for market analysts.[4]

CFA does not anticipate that the current hard market will last long. The capital inflow exceeds the terrorism loss, leaving the industry overcapitalized.

The larger firms with the most problems in price and coverage availability have alternatives to traditional terrorism insurance such as self-insurance, "layering" (i.e., buying many small insurance contracts to replace one large one), creation of captive insurance companies and even securitizing the risk.

Insurance is largely available, even to the highest risks. Reuters reported that "Commercial insurance is available to airlines, but at huge cost. A source at a major international insurance broker said $1 billion of liability cover for war and terrorism would cost about $3.10 cents per passenger."[5]

CFA has found no broad economic problems caused by the terrorism insurance situation. For instance, Standard & Poor's believes that "The ratings implications for corporates are likely

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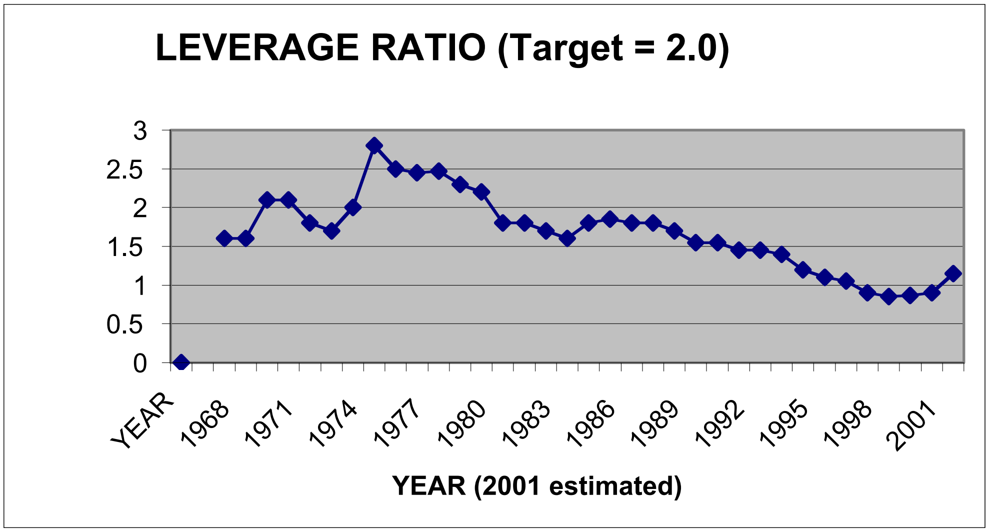
[4] "Chubb Makes Happy Forecast After A Drop," Daniel Hays, National Underwriter Online News Service, February 7, 2002.
[5] "UK Extends Airline War Insurance For Last Time," Reuters, January 21, 2002.

to be very limited and selective."[6] Even in New York, the epicenter of the terrorist attack, the economy appears to be improving, according to the Federal Reserve Board.[7]



The above chart shows the financial strength of the industry. A "leverage ratio" is the ratio of net premiums written (i.e., after reinsurance) to the surplus; the amount of money the insurer has to back-up the business (assets less the liabilities). Surplus differs from reserves, which are liabilities set up to cover claims. The leverage ratio has always been the key measure of insurer strength.

The rule of thumb used for decades by insurance regulators and other experts in determining solidity is the so-called "Kenny[8] Rule" of $2 of premium for each $1 of surplus as safe and efficient use of capital. Some now say that this rule is antiquated, given the new level of catastrophe possible, but new ways of spreading the risk, such as securitizing it, may offset this. CFA still believes a 2:1 ratio is safe. But even those proposing a lower ratio do not suggest ratios below 1.5:1. The NAIC uses a 3:1 ratio as the standard for determining if an individual insurer warrants solvency inspection. The chart shows that current and recent ratios fall well within these measures of safety.

[6] "S&P: Insurers to Cut Cover for Losses Due to Terror," S&P Business Wire, January 9, 2002.
[7] "Fed Economic Outlook," Associated Press, January 15, 2002.
[8] Named after a famous insurance financial writer, Roger Kenny.

Market Conditions Since Release of the CFA Study

CFA has continued to review the market since our initial report was finished in late January. The conclusions continue to hold in late February. We realize that there are some limited problems, but nothing requiring broad, immediate federal action.

For confirmation of this, consider a recent Prudential Financial survey.[9] The key findings of the Prudential survey of 120 major commercial businesses' risk managers were:

- Individual programs are going through an extensive re-underwriting process. Most risk managers surveyed said that insurers are asking more questions and the renewal process is taking much longer to complete than in previous years.
- Average price change statistics are meaningless. Rate changes vary considerably by program.
- 68 percent of risk managers surveyed reported tighter terms and conditions in recent renewals; 79 percent who have not renewed expect tighter terms and conditions.
- Business is moving to new carriers but not for a lower price. A larger number of programs are changing underwriters with the most frequently cited reason being less stringent terms.
- Brokers are not suffering unduly from the effects of the hard market—broker services are still in demand.

In its survey, Prudential Financial found that 70 percent of the participants who had renewed their insurance noted an average premium increase of 18 percent.

Prudential reported comments of the risk managers who offered such thoughts. The comments show that lack of terrorism coverage is not a major concern compared to prices and even to other coverage cutbacks such as increased retentions (see chart below). The concerns are consistent with a normal hard market. The reason most often given for the price rises by the risk managers was opportunistic pricing by the insurance companies.

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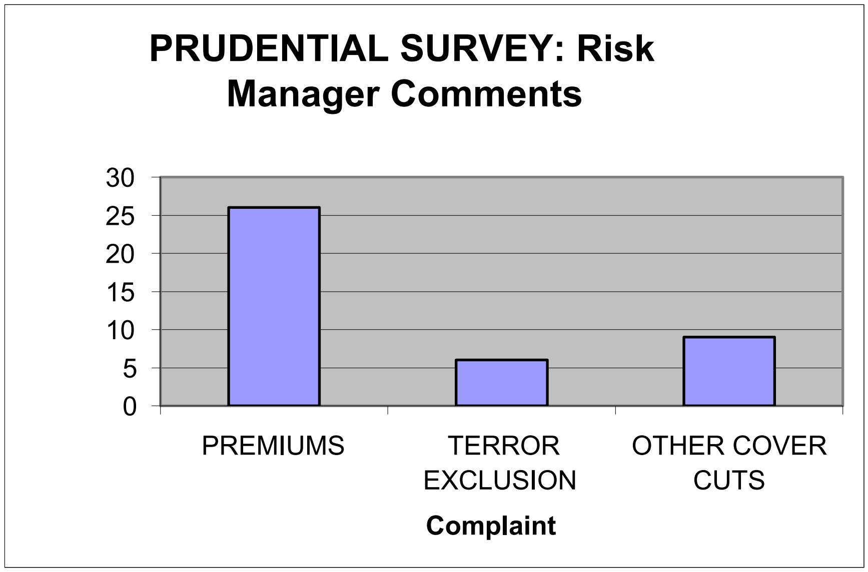
[9] "2002 Insurance Buyers' Survey," Prudential Financial, January 25, 2002.



What Congress Should Do to Help Consumers, Businesses and Insurers

As I said, CFA supported the House terrorism insurance approach (H.R. 3210) that passed the Financial Services Committee.[10] CFA commends the committee members for their work on the bill, particularly Chair Oxley, Subcommittee Chair Baker and Ranking Member LaFalce.

CFA testified that, while we were unsure what would happen if Congress did not act to provide back-up for terror coverage, we thought that the potential consequences were "…severe enough that Congress should worry…"[11]

However, after January 1st of this year, when 70 percent of reinsurance contracts came up for renewal, the "sky did not fall," contrary to some of the predictions that were made. The private sector seems to be adjusting to the reality of the hard market and limited unavailability of terrorism coverage.

Given the actual situation, here is what CFA recommends that Congress do now:

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[10] CFA opposed the version of H.R. 3210 that passed the full House because of draconian liability restrictions that were added on the Floor.

[11] Testimony of CFA Director of Insurance J. Robert Hunter, Senate Commerce Committee Hearing, October 24, 2001.

A. Don't Rush Into Passing a Back-Up Bill

Congress has ordered the General Accounting Office (GAO) to review the insurance market and determine if there is a problem. This is an excellent first step.

It would be a good idea to hold hearings, not only to examine market conditions, but also to look into private alternatives to federal back-up.

If a terrorist event occurs again there will be terrorism insurance in place on the vast majority of risks. That is now clear. Even the Olympics, surely a prime target, secured coverage.[12] Stand-alone terrorism coverage is "easy to obtain for good risks."[13] Terrorism reinsurance is available on a facultative basis, but getting it on a treaty basis is harder.[14] "Greater leniency on terrorism cover in particular seems to have won the (reinsurance) start-ups market share at the expense of other markets, especially Lloyd's," says a report issued by the London-based reinsurance intermediary, Benfield.[15] Even target risks such as new construction projects can usually get it.[16] And large reinsurers are contemplating setting up a separate company to write terror risks.[17] Insurers are developing ways to rate terror coverage, including developing new computer models for that purpose.[18]

Even some of those risks not securing "normal" insurance have found ways to effectively cover the risk of terrorism. Some are using the Liability Risk Retention Act to cover the liability part of the terrorism risk. Terrorism and even war liability are being covered by airlines, through a risk retention group formed in Vermont.[19] Captives are forming to cover terrorism, for instance for construction trades.[20] And banks are freely loaning money, often at somewhat higher rates so they are bearing some of the risk in that way.[21]

Thus, inaction by the Congress, which CFA thought was a mistake last year, has had a very positive result – it has fostered private sector innovation.

Are there problems in the market? Sure. But they are being resolved. And Congress can always act after an event, even quickly, as you did with the airline bailout bill. We urge

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12 "Insurers Learn from Federal Inaction on Requests for Terror Aid," BestWire, February 20, 2002.
13 "Terror Coverage Market Grows," Business Insurance, February 18, 2002.
14 "Insurers Scramble for Cover," National Underwriter, February 18, 2002.
15 "Pricing Competition Returns to Reinsurance Market," National Underwriter, February 18, 2002.
16 "Terror Risk hits new Construction," Business Insurance, February 18, 2002.
17 "Big Europe firms discuss terror insurer scheme," Reuters, Feb 21, 2002
18 "Cat Modeling for Human Disasters," National Underwriter, February 13, 2002.
19 "U.S. airlines have plan to cover war liability risks," Reuters, February 11, 2002.
20 "D.C. Grants Second Captive License," National Underwriter, Jan. 31, 2002.
21 "Bankers Plugging Terrorism Insurance Gap," National Underwriter, Feb. 11, 2002.

Congress to go slow and allow these private sector alternatives to develop. Indeed, as I suggest below, you should consider ways to encourage such developments.

B. No Handouts are Warranted

If one thing is clear, it is that Congress should not do a taxpayer-funded bailout of this well-capitalized industry. If any federal back-up is required, it should be a loan program modeled after the House bill, not a hand out that does not require assistance to be paid back.

C. Create Incentives for the Development Of Private Sector Alternatives

Instead of spending time working on what appears likely to be an unnecessary taxpayer back-up of the insurance companies, Congress should provide incentives for the creation of the fast-developing private alternatives to the over-priced insurance in today's market. Consideration should be given to such ideas as:

- Expanding the Liability Risk Retention Act to cover property insurance.
- Determining if there are any tax disincentives for the development of captive insurance or self-insurance mechanisms.
- Developing proposals to encourage the securitization of risk.

Congress has created incentives for private sector alternatives before, with the Risk Retention Act (RRA). The Product Liability Risk Retention Act of 1981 was developed by Congress as a direct result of the product liability insurance hard market of the mid-1979s. The current version of the Act, the Liability Risk Retention Act of 1986,[22] was passed to expand the Act to all commercial liability coverages as a direct reaction to the hard market of the mid-1980s. It allowed businesses to join together to form purchasing groups to buy liability insurance as a unit or to form self-insurance combinations by getting approved in only one state. The airlines are already using the act to create a private solution for terrorism coverages for liability. They should be able to cover their property (hulls) in a similar manner.

[22] 15 USC §3901 et sec.

If the airlines, surely a target, can find private solutions, the NFL and other large commercial businesses with the ability to spread risk could take this approach, rather than seeking a taxpayer-backed handout[23].

The NAIC describes the RRA as follows:

> The purpose of the RRA is to increase the availability of commercial liability insurance which became severely restricted in the market crisis of the mid-1980s…An RRG[24] is a risk-bearing entity that must be chartered and licensed as an insurance company in one state…Once the group has obtained a license, it may operate in all states…and is regulated almost exclusively by the domiciliary commissioner…The RRA requires that the RRG be owned by its insureds and requires the insureds to have similar or related liability exposure. The only type of coverage an RRG is permitted to write is commercial liability insurance for its members and reinsurance with respect to the liability of any other RRG…A PG[25] may purchase only commercial liability insurance for its members…[26]

CFA believes that the creation and expansion of the RRA helped to overcome the problems of the two previous hard markets and would do so again in the current hard market. Not only would expansion of the Act enable small- and mid-sized businesses to get together to cover other risks, the alternative puts pressure on the insurance industry to stop the price gouging now underway or risk losing market share.

CFA calls on Congress to expand the RRA to cover all lines of property/casualty insurance, including property and workers' compensation. Consideration should be given to expanding the Act to cover group life and group health contracts, since many businesses getting together would eliminate the aggregation problem in these lines of insurance.

Finally, the hearings on expanding the RRA should also consider the creation of a personal lines version of the Act because, even though the terrorist problem is not severe in

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23 The NFL has 32 stadiums across the nation as well as other properties. Further, there are many other professional arenas (not to mention college and school facilities) that could be included in a RRG to cover terrorism insurance.

24 RRG is a Risk Retention Group operating under the RRA, the Risk Retention Act.

25 PG is a Purchasing Group.

26 <u>Risk Retention and Purchasing Group Handbook</u>, NAIC, 1999, Pages I1-I3.

personal lines, there are obstacles to the use of efficient group sales of home and auto insurance that RRA would overcome.

D. Address Rate Gouging in any Bill that Passes

If a back-up bill is considered, the bill must adequately address the problem of the price of insurance. It would be foolish to pass a back-up bill and not assure that insurance rates are rolled back to reflect the reduced level of insurer risk that would occur from the creation of the federal back-up.

Hearings held on terror insurance legislation should include consideration of:

- Requiring rate reductions equivalent to the amount of back-up provided. For example, if terrorism coverage is 10% of the rate increase, and the taxpayer is backing up 90% of that subject to later pay back, the premium increase should be rolled back by 9%.
- Requiring states to certify that rates are not excessive. Certainly, any bill that is considered should not prohibit pre-approval of rates, as one Senate draft contemplated.
- Requiring a terror insurance line item on the bill. It is very important that businesses can see the price differences for terrorism and other coverages. This would allow business to determine if other coverages are being unduly hiked vis-à-vis the businesses' claims experience.

What the States Should Do

The CFA report made several recommendations to the states, including:

A. Reject Exclusions for Personal Lines of Coverage

The states adopted this recommendation.

B. Reject Exclusions for Commercial Lines for Small and Mid Sized Insureds

Many states allow exclusions, even for small business. CFA has asked the states to revisit this decision since small business should be treated in the same way as personal lines.

C. Require the Cost of Terror Insurance Coverage as a Line Item on The Bill

The states could do this now under their current authority. (See discussion under federal proposals, above.)

D. Review Pricing in the Marketplace, to Prevent Price Gouging, Particularly for the Non-Terror Part of Rates for Smaller and Mid Sized Commercial Insureds.

The actuarial considerations are well known for these coverages. There is no reason why the states should not step into the current non-competitive market and assure the business insurance consumers of their states that the rates meet the "not excessive" requirements of state statute. The states should undertake rigorous analyses of ratemaking methods and rate filings and make sure such an analysis is available to the public.

E. Reject the Model Commercial Lines Deregulation Bill Now Before the NAIC for Approval in March, or at Least Delay it Until Price Gouging is Not Present in the Market.

The states need to assure the buyers of business insurance that they are doing their job to protect them. Certainly, with price gouging occurring in the market even for large risks, now is not the time to be deregulating commercial lines. The NAIC should table or reject this Model Bill.

Madame Chair, I will be happy to respond to questions at the appropriate time.

How the Lack of Federal Back Up for Terrorism Insurance Has Affected Insurers and Consumers:

An Analysis of Market Conditions and Policy Implications

A Report by the Consumer Federation of America

January 23, 2002

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I. Introduction

In the wake of the terrorist attacks of September 11, 2001, many concerns were raised about the impact of this unprecedented and tragic event on insurers and insurance consumers, including businesses. Insurance industry losses from the attacks were estimated to be as high as $70 billion. Approximately 70 percent of all reinsurance contracts were due to expire at the end of the year, making it virtually impossible for primary insurers to get back up for future terrorism losses. Without this reinsurance, there was great fear about what would happen to the price and availability of insurance—and to the economy as a whole--if Congress didn't provide federal terror insurance back up. There was broad consensus among interest groups (including consumer organizations) and lawmakers of both parties that federal assistance was necessary, but disagreement about how to provide it. Ultimately, Congress adjourned in December without enacting terrorism insurance legislation.

The purpose of this report is to evaluate the effect of the terrorist attacks—and the lack of federal back up—on insurance rates and availability, and on the financial condition of the insurance industry. The report also outlines new policy options that the states and Congress should consider to guarantee affordable terrorism coverage to individual and business consumers.

II. Status of the Insurance Market Today

A. Losses from the World Trade Center Attack Will be Less Than Anticipated

Insurance losses stemming from the World Trade Center attacks will be far less than first anticipated, according to New York State Insurance Superintendent Greg Serio. He told the New York State Senate Insurance Committee on January 14, 2002 that total payouts should reach $35 billion before the effects of taxes, far less than the $70 billion projected by the industry and the $60 billion first anticipated by his Department.[1]

This is the largest single insured loss in history in dollar terms. The previous record was Hurricane Andrew, which hit Florida and the Gulf Coast in 1992, causing $16 billion in pre-tax insured losses.

The projected after tax impact of the September 11 events is a loss of $23 billion.[2] Hurricane Andrew's post-tax hit on the insurance companies was $10 billion.[3]

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[1] New York Post, January 15, 2002. The new projections are due to a lower death count and not as many business losses as expected.
[2] $35 billion in pre-tax losses less the 35% corporate tax write-off applicable to claims.
[3] $16 billion in pre-tax losses less the 35% corporate tax write-off applicable to claims.

The impact on the bottom line of the insurance industry from the September 11 terrorist attack was 7.2% of surplus as of the beginning of 2001.[4] The impact on the bottom line of the insurance industry from the 1992 Hurricane Andrew event was not much less: 6.3% of surplus as of the beginning of 2001.[5]

B. The Insurance Industry is in a Very Strong Financial Position After the Terrorist Attacks

Many analysts are predicting that 2002 could be a very profitable year for the insurance industry.[6] [7] [8] In the first ten weeks after the terrorist attack, the insurance industry saw a surge in capital of $24.4 billion, according to Morgan Stanley.[9]

Thus, a key CFA finding is that the insurance industry is now better capitalized than before September 1, 2001. The capital lost by September 11th was about $23 billion and the new capital already booked by the industry is over $24 billion.

To be sure, the "lost" capital and the "new" capital are not necessarily in the same insurance companies, but the industry as a whole is more strongly capitalized now than when the terrorists struck – surely a victory for capitalism over terrorism.

Anticipating high returns in a hard market, some of this capital has flowed to new offshore reinsurance companies.[10] A number of new companies, most of which were created by existing industry leaders,[11] have been capitalized with as much as $9 billion.[12] [13]

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4 $23 billion in post-tax loss divided by the starting surplus of $321.4 billion (per 2001 Edition of Best's Aggregates and Averages).

5 $10 billion in post-tax loss divided by the starting surplus of $158.7 billion (per 2001 Edition of Best's Aggregates and Averages).

6 "The expected rise in rates and tightening of coverage terms and conditions will boost industry profitability this year, the respondents [industry leaders who were surveyed] added…. Ninety percent predicted higher profits in commercial lines (excluding workers' compensation, for which only 65 percent expect better results). "Analysts: Hard Market Might Be Short-Lived." National Underwriter Online News Service, January 16, 2002.

7 "Despite an expected $50 billion plus in claims stemming from the World Trade Center collapse, not to mention damage from lat year's heavy flooding and storms, the insurance industry is poised to do quite well. The September 11 attacks stimulated demand for property and casualty insurance and provided a rationale for a new round of hefty premium boosts. Moreover, insurers are limiting their losses to terrorism by raising deductibles or excluding some coverage, if state regulators say OK. Life insurers, too, report higher sales as people reassess family responsibilities. Also climbing are rates for auto and homeowner coverage. Premium hikes across the industry will be outpacing the growth in claims…Another sign of strength: the formation of new firms, including a joint venture by powerhouses AIG, Chubb, and Goldman Sachs." "Insurance: Surprising Survival in a Risky Business," U.S. News and World Report, January 14, 2002.

8 "Soaring premium volume, tighter underwriting, an influx of capital, a recovering economy, and a rising stock market will combine to make 2001 an anomaly. Absent more terrorist attacks or major natural disasters, industry results will improve dramatically next year." "Top 10 Stories of 2001," National Underwriter, December 24/31, 2001.

9 "'The capital markets raised $24 billion in 10 weeks, which is breathtaking,' said Alice Schroeder, managing director of Morgan Stanley in New York. 'In addition, many companies that were hit hard [by terrorist attack claims] on 9/11 entered the 1/1 renewal season with at least as much, if not more capital than they had on 9/10. There's plenty of capacity out there.'" National Underwriter Online News Service, January 16, 2002.

10 "New entrants could grab up to $6.5 billion in reinsurance premium this year, out of a total estimated volume of $110 billion, Standard & Poor's predicts." Professional Insurance Agents Association Web Site, January 16, 2002.

The new capital, the prospect of increased demand for property-casualty insurance and lucrative premium increases has strengthened the position of the largest insurance companies on Wall Street. The average stock price for the seven largest insurers has increased by 2.6% since the closing stock price of September 10th, an annual rate of 7.8% (see Appendix A).

C. There are Manageable Problems in Insurance in The Wake of September 11th

1. The Biggest Concern is High Commercial Insurance Rates

According to data released by the Council of Insurance Agents (CCIA) and Brokers,[14] commercial premiums are increasing quickly. According to estimates made by CFA based upon the CCIA data for the 12-month period ending December 31, 2001, average prices rose as follows:

Small Commercial Accounts	+21%
Mid-size Commercial Accounts	+32%
Large Commercial Accounts	+36%

The worst hit are "terrorist target" risks, such as skyscrapers. According to the CCIA survey, CFA calculates the average increases over the last year by line of insurance as:

Business Interruption	+30%
Construction	+46%
Commercial Cars	+28%
Property	+47%
General Liability	+27%
Umbrella Liability	+56%
Workers' Compensation	+24%

Interestingly, the broad rate increases are occurring even when terrorism is excluded. The market shows all the earmarks of a classic cycle bottom, which is discussed in some detail below.

The price for terrorism coverage is very high and coverage appears to be limited, requiring higher self-insured retentions (deductibles) and lower aggregate limits.

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11 "Almost all of them [new reinsurance companies] are vehicles created by some of the industry's biggest insurance companies and brokers, including AIG, Aon, Marsh, State Farm, Zurich and others of similar size." "Report Reinsurance Rate Rise Reduced," Reuters, January 14, 2002.

12 "The companies are among eight insurers and reinsurers that have formed in Bermuda since the Sept. 11 terrorist attacks in the United States. The startups so far have raised more than $9 billion in capital." "Two More Reinsurers Form in Bermuda," Business Insurance Daily News, January 21, 2002.

13 "Much of the new capital went to Bermuda, where at least six new insurers have been capitalized with a total of more than $6 billion. At least another $3.37 billion was raised by existing facilities." "Year in Review," Business Insurance, December 24, 2001.

14 4th Quarter 2001 Survey, released January 2002.

2. Some Large Commercial Insureds are Having Difficulty Getting Sufficient Terrorism Coverage from the Normal Insurance Market

Besides the high rate problem, there appears to be difficulty for very large commercial risks in getting terrorism coverage in amounts similar to the levels enjoyed in previous years.

The individual risk (homeowner and car owner) appears to be able to get full coverage with only modest price increases forecast for 2002 (in the 4 to 6% range). These modest increases highlight the lack of impact that the terrorist attacks had on personal lines of insurance. Nonetheless, insurers have petitioned the National Association of Insurance Commissioners to allow them to exclude terror coverage for personal lines of insurance. CFA has urged the NAIC to disapprove this request.

Consistent with a classic cycle turn, small commercial accounts are seeing much higher increases (in the 15% to 25% range). Terrorism coverage for smaller commercial accounts has been excluded if insured losses from a terrorist attack exceed $25 million. The coverage can be bought back at a price that is manageable for most small businesses.

Mid-size businesses are also seeing high price increases (in the 25% to 35% range, also with the terrorism cover excluded. The cover can be frequently be bought back at a price that is manageable.

Very large risks are seeing the largest price rises (+30% to + 40%) and having the hardest time finding the usual terrorism insurance coverage. It should be noted, however, that even some of the businesses that are most at risk of future terrorist acts—such as airlines--have been able to procure liability insurance coverage.[15]

Fortunately, these large and sophisticated accounts have a wide array of alternatives to normal insurance, including self-insurance, layering of coverage through the use of many insurance companies, use of captive insurance companies, the non-standard, off-shore market and even risk securitization. We discuss these options in more detail later in this report.

3. Commercial Insureds Generally Appear to be Getting Loans Without Terrorism Coverage

According to an article in the January 7, 2002 edition of American Banker, there is little if any problem with loans in the current market for terrorism insurance. No federal bank regulator has issued any guidance on the terrorism insurance issue since they have seen no solvency problems developing from any real or perceived lack of coverage.[16]

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[15] "A source at a major international insurance broker said $1billion of liability cover for war and terrorism would cost about $3.10 per passenger." "UK Extends Airline War Insurance For Last Time," Reuters, January 21, 2002.

[16] "'We haven't discussed putting out any guidance, either internally or with other regulators,' said David D. Gibbons, the deputy comptroller for credit risk at the Office of the Comptroller of the currency. 'We would need to see some evidence that this issue has impacted credit availability. We have not seen that. No one has come to us and said this is curtailing lending.'" "No Terror Insurance, But Lenders Still Lending," American Banker, January 7, 2002.

Banks seem to be treating it, according to the article, as just another factor to consider in making loans. For example, the article states, "'We have to factor it into our risk on a case-by-case basis, but insurance is just one of many factors we take into consideration,' said William L. Perotti, the group executive vice president and chief credit officer at Frost National Bank in San Antonio... 'I'd hate to see us deny credit to a creditworthy borrower just because their insurance didn't cover acts of terrorism. You just can't do that.'"

Banks have made it very clear that, contrary to predictions made by some insurers, they will not be calling any loans because of the loss of terrorism coverage by a mortgagee.[17] [18]

D. This is a Classic "Hard" Cycle--with Prices Rising--Accelerated by the Events of September 11th

Insurance is a cyclical business. This is particularly true in the commercial insurance business.

In the mid-1970s, the country experienced the first liability insurance crisis. In this case, the crisis was particularly acute in product liability insurance and medical malpractice insurance.

At the mid-70s cycle low, the industry's rate of return was "2.6% in 1975," rose "to 19.7% in 1977, a gain of almost 17 points in the course of only two years. The industry's rate of return then fell by more than 17 points over the next 7 years to 1.9% in 1984, the nadir of that soft market. During the subsequent hard market, profits once again shot up…to 15.4%" (by 1987).[19]

The mid-1980s crisis was in commercial liability generally, hitting municipalities, day care centers, environmental liability and many other liability risks and lines. *Time* magazine had a cover story called "Sorry America, Your Coverage is Cancelled."

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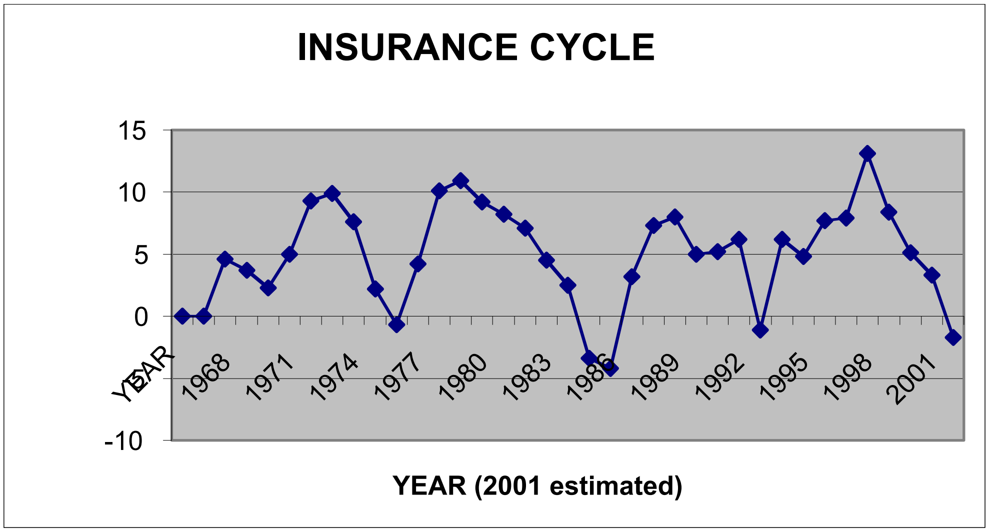
[17] "As it lobbied for a terrorism-insurance bill, the industry told lawmakers that a lack of affordable coverage would hurt a hoped-for economic recovery, as banks would be unwilling to make loans to projects not backed by full insurance coverage. While the insurance is more readily available than predicted, the jury is still out as to how the high prices will affect policyholders. One positive sign: According to insurance brokers, banks aren't pulling their financing for clients who lack the coverage, as had been by some proponents of the federal insurance program. Instead, they are charging higher fees for some customers who are going without terrorism coverage." Wall Street Journal, January 4, 2002.

[18] "As legislation to establish a federal reinsurance program stalled over politics, many warned that bankers might start calling in loans for existing projects. … However, all of the lenders interviewed for this article were unanimous in saying they will not call in loans for existing projects that lost terrorism coverage on Jan. 1. 'We have a half-dozen deals where we are requiring terrorism insurance,' said Fleet Boston's Mr. [John] Mastomarino. 'They'll get it. It'll cost them more. But in our opinion it will not be so prohibitive as to hurt the economics of the deal that much. When you're talking about big projects, on a percentage basis of the overall cost it is quite small.'" "No Terror Insurance, But Lenders Still Lending," American Banker, January 7, 2002.

[19] Cycles and Crises in Property/Casualty Insurance: Causes and Implications, edited by Cummings, Harrington and Klein, NAIC, 1991. Page 11.

Two charts below show the cyclical nature of insurance.[20] The first chart, "Insurance Cycle" shows the operating income as a percentage of premium from 1967 to 2001. The operating income of the industry falls below zero four times on the chart – in 1975, in 1984 and 1985, in 1992, and in 2001 (the last number estimated by CFA).



The 1992 data point was not a classic cycle bottom, but reflected the impact of Hurricane Andrew and other catastrophes in that year.

The 1975 and mid-80s bottoms were both classic cycle bottoms with very sizeable price increases and coverage availability problems immediately following the bottom. Consider the mid-80s cycle turn: between 1977 and 1984, insurance premiums had "…actually declined (by) 4.4%…From 1984 to 1987, net premiums written increased 63.3%…"[21]

The price increases in this cycle turn began in late 2000.[22] The rate of change was accelerating upward before September 11th. The terrorist attacks sped up the price increases into what some seasoned industry analysts see as gouging.[23] Many examples of unjustified price increases have surfaced in the last few months.[24] [25]

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20 Both of these charts use data from A. M. Best and Co., Aggregates and Averages, 2001 edition for all years except 2001, where CFA made estimates of the results based on current information.

21 Cycles and Crises in Property/Casualty Insurance: Causes and Implications, edited by Cummings, Harrington and Klein, NAIC, 1991. Page 8.

22 "The Big Question For 2002: Will Hard Market Last Long?" By Sean F. Mooney, National Underwriter, January 7, 2002 edition.

23 "…there is clearly an opportunity now for companies to price gouge – and it's happening…But I think companies are overreacting, because they see a window in which they can do it." Jeanne Hollister, consulting actuary, Tillinghast-Towers Perrin, in, "Avoid Price Gouging, Consultant Warns," National Underwriter, January 14, 2002.

24 "As Insurers Hike Prices, State Regulators Consider Reducing Regulatory Authority," Consumer Federation of America, December 5, 2001.

25 "We've seen premiums go up as much as 40-70 percent," says [Jenny] Jones [CEO of Elkins/Jones insurance brokerage]. She points out that commercial buildings which now pay five or six cents per square foot for insurance need to budget for costs to go up to as much as seven or eight cents a foot. She says the increases could be across

Gouging usually does occur as the cycle turns.[26] The evidence is very strong that what we are experiencing is a classic underwriting cycle turn into a "hard," from a prolonged "soft," market.

According to the National Association of Insurance Commissioners, "…underwriting cycles may be caused by some or all of the following factors:

1. Adverse loss shocks…unusually large loss shock…may lead to supracompetitive prices.
2. Changes in interest rates…
3. Under pricing in soft markets…"[27]

Prior to September 11th, the industry had been in a soft market since the late 1980s. The usual six to ten year economic cycle had been expanded by the amazing stock market of the 1990s. No matter how much they cut their rates, the insurers wound up with a great year when investing the float on the premium in this amazing market (the "float" occurs during the time between when premiums are paid into the insurer and losses paid out by the insurer – e.g., there is about a 15 month lag in auto insurance). Further, interest rates were relatively high in recent years as the Fed focused on inflation.

But, in the last two years, the market turned with a vengeance and the Fed cut interest rates again and again. Item 2 above had occurred well before September 11th.

Item 3 above, the low rates, were also apparent. The chart, "Insurance Cycle," shows the operating profit drop from about 13% of premium in 1997 to about 3.5% of premium in 2000.

So, before September 11th, the cycle had turned, rates were rising and a hard market was developing. An anticipated price jump of 10% to 15% in 2001 was predicted by CFA and confirmed by the Insurance Information Institute.

Item 1, the shock loss was all that was missing. September 11th provided that in an achingly painful way.

However, the increases are mostly due to the cycle turn. The price increases were sped up by the terrorist attack, collapsing two years of anticipated increases into a few months, but the bulk of the increases are not related to pricing for terrorism, per se. This is a classic economic cycle.

The question we hear a lot of debate about is how long the hard market can last. Given the amazing inflow of capital, can the prices hold for long?

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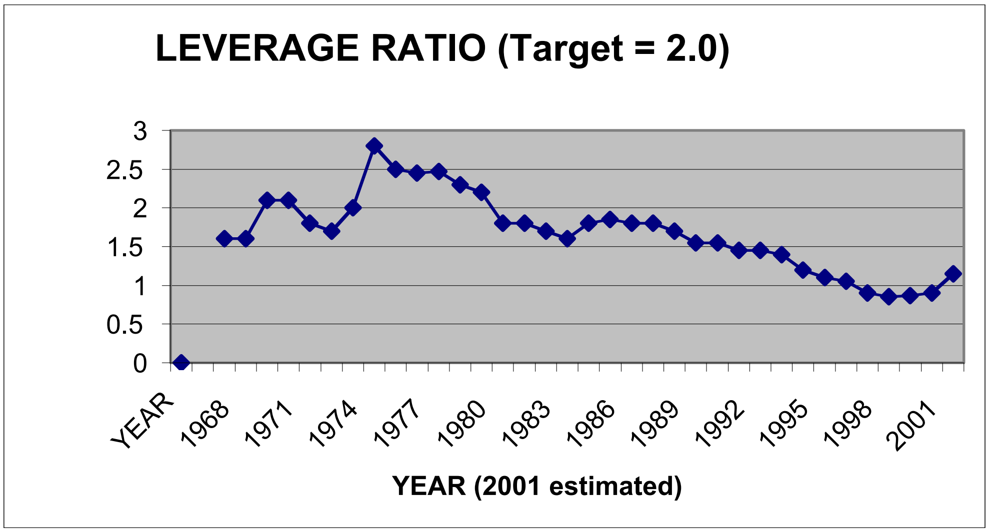
the board for all types of properties. Single family housing developers could be sharply affected, she notes, citing one homebuilder whose liability premium doubled at the November 11 renewal." "Large Insurance Premium Increases in 2002 as September 11 Ricochets Through Industry, Expert Advises," Business Wire, January 3, 2002.

[26] "To be sure, the market began firming in 2000. But the Sept. 11 terrorist attacks sent insurance prices skyrocketing far beyond the estimates of increases that earlier were being attributed to a normal hard cycle." "Year in Review," Business Insurance, December 24, 2001.

[27] Cycles and Crises in Property/Casualty Insurance: Causes and Implications, edited by Cummings, Harrington and Klein, NAIC, 1991. Page 339.

While the jury is still out on that question, there are some factors that make it seem likely that the hard market will be brief. They include:

- The capital inflow in excess of the after-tax terrorism loss,
- The relatively overcapitalized position of the industry as shown in the chart, "Leverage Ratio," below,
- The availability of alternative risk mechanisms to the larger client risks, the insureds with the biggest price hikes,
- The pattern of risk managers blaming insurers, not the terrorism event, for renewal problems, and shopping for better deals.[28]



A "leverage ratio" is the ratio of net premiums written (i.e., after reinsurance) to the surplus, the amount of money the insurer has to back up the business; assets less the liabilities. Surplus is not reserves, which are liabilities set up to cover claims. The leverage ratio has always been the key measure of insurer strength.

The rule of thumb used for decades by insurance regulators and other experts in determining solidity is the so-called "Kenny[29] Rule" of $2 of premium for each $1 of surplus as safe and efficient use of capital. Some now say that this rule is antiquated, given the new level of catastrophe possible, but new ways of spreading the risk, such as securitizing it, may offset this. CFA still believes a 2:1 ratio is safe. But even those proposing a lower ratio do not go below 1.5:1. The NAIC uses a 3:1 ratio as the standard for determining if an individual insurer warrants solvency inspection.

When the cycle turned in the mid-70s, the premium/surplus ratio was as high as 2.8 to 1. This was a dangerously high average ratio since many insurers exceeded the 3:1 NAIC problem ratio. When the mid-80s cycle turned, the ratio was as high as 1.8 to 1 – a relatively safe level.

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[28] "Risk Managers Blame Insurers for Renewal Woes," National Underwriter, January 14, 2002
[29] Named after a famous insurance financial writer, Roger Kenny.

In today's cycle turn, CFA projects the ratio for 2001 year-end to be about 1.2 to 1, extremely safe and, indeed, overcapitalized.

E. Larger Firms – the Locus of the Current Insurance Problems – Have Many Alternatives to Traditional Terror Insurance Coverage

Many high risks are adapting to the current market by using a variety of alternatives available to them[30] [31], such as:

1. Self-insurance – under this method, a large risk simply self-insures more of the risk than heretofore. This can take many forms including: larger retention or deductible, taking layers of the risk above some insured portions, taking lower coverage limits, etc. This is not "going bare" since a plan is in place to reserve for or otherwise cover the potential losses.

2. "Layering" – Under this approach, the large account buys many small insurance contracts to replace one large one if large amounts of insurance are not available. Insurance brokers are expert at finding ways to layer together a package, which replicates coverage of the previous year's size.[32]

3. Captives – here the large risk, alone or with other similar businesses, creates an insurance company to write the risk. These companies are often offshore, but a few states have captive programs (e.g., Vermont.)

4. Securitizing risk – In the wake of Hurricane Andrew, several insurance companies obtained a new form of protection against risk: the securitization of risk by means of Act of God Bonds and other financial instruments. This is a very attractive option for terrorism risk as well, since financial markets have huge assets and are able to withstand price swings that make insurance catastrophes seem tiny by comparison.

[30] "The German chemicals group BASF said on Wednesday that it was talking to other blue-chip firms about setting up their own reinsurance company to provide protection against terror risks no longer covered by reinsurers. "BASF Mulls Own Reinsurance with Other Companies," Reuters, January 16, 2002.

[31] "As opposed to prior hard markets, businesses in 2002 have a lot more options to manage exposures than through the pure transfer of risk by insurance. In considering these options, businesses need to assess when the current upturn in pricing will peak, and when pricing will return to rates that clients consider acceptable. … The use of alternative risk-transfer vehicles is well developed. As insurers see that their customers are walking away, self-insuring rather than paying directly for risk transfer, they might be more inclined to decrease prices." "The Big Question For 2002: Will Hard Market Last Long" Sean F. Mooney, National Underwriter, January 7, 2002.

[32] "While underwriters, in many cases, are unwilling to provide the same limits they did a year ago, brokers have been able to fill gaps in coverage through layered programs. And, not surprisingly, they are seeing renewed interest among clients in alternative risk transfer options." "Brokers Pressed to Meet Coverage Needs," Business Insurance, January 14, 2002.

Eventually, many analysts expect insurers to find ways to cover the risk of terrorism under traditional property-casualty policies.[33] [34]

F. The Lack of Federal Terror Back-up Has Not Adversely Affected the Economy

Whatever problems are occurring for some companies with terror coverage, they do not appear to have caused broad economic consequences. For instance, consider the following Standard & Poor's position on rating businesses without terrorism insurance:

> "The ratings implications for corporates are likely to be very limited and selective," said Sol Samson, a managing director with Standard & Poor's Corporate Ratings group. "The additional risk may emanate from lack of coverage or much greater expense to obtain coverage. But the impact would be material only in situations where the perceived specific risk of a terrorist incident was high -- just as lack of earthquake insurance isn't a problem in regions that don't face much risk of such natural events." Furthermore, the impact would be diluted to the extent a company is diversified, i.e., operates many plants or facilities. In addition, even in cases that might be considered to carry serious terrorist attack potential, possessing insurance coverage could sometimes be irrelevant. "If cruise ships were perceived as targets, who would take cruises? If a landmark building were viewed as vulnerable to terrorist attacks, what rents could it command? Insurance cover for the boat or building wouldn't resolve the risk exposure," Samson added.[35]

Even in New York, the epicenter of the terrorist attack, the economy appears to be improving, according to the Federal Reserve Board:

> NEW YORK - Economic activity showed further signs of rebounding. Retailers said sales appeared to be gaining momentum in late December and early January. Business contacts said inventories were lean. Labor market exhibited signs of stabilizing. Unemployment insurance claims in New York City appeared to have retreated to levels seen before the Sept. 11 terror attacks. Housing market in most of district strengthened, except for Manhattan's rental market, which remained slack. Hotel occupancy rates continued to recover, but were down from a year earlier.[36]

CFA can find no widespread problems caused by the terrorism insurance situation in the United States as of January 19, 2002.

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[33] "Even if Congress stays on the sidelines, insurers—drawn by the promise of higher premiums and reassured by careful underwriting—will find terrorism exposures not nearly as intimidating as natural disaster risks, and will eventually write coverage for most clients at little if any additional charge." National Underwriter, December 24/31, 2001.

[34] Private markets for terrorism coverage might yet develop. Some savvy risk managers could come up with a private terrorism reinsurance pool. Or perhaps the major insurance brokerages will put a facility together. Also, we would not be surprised to see a 'Terrorism Re' in Bermuda sometime soon, following in the footsteps of those entrepreneurs who dared to write property-catastrophe coverage after Hurricane Andrew." National Underwriter, December 24/31, 2001.

[35] "S&P: Insurers to Cut Cover for Losses Due to Terror," S&P Business Wire, January 9, 2002.

[36] "Fed Economic Outlook", Associated Press, January 15, 2002.

G. Conclusion

CFA has come to five major conclusions about the current state of the insurance market, especially as it relates to terrorism coverage:

1. The insurance industry is wealthy and overcapitalized.
2. High rates are a problem for mid-size and larger insured firms.
3. The rate problem is caused by the classic turn in the economic cycle of the industry, sped up – but not instigated --by the terrorist attacks.
4. Banks are freely loaning money to the vast majority of -- if not all — businesses, regardless of the terrorism insurance situation in the nation.
5. There are presently no widespread economic problems related to the terrorism insurance situation in America today.

These findings have important implications for Congress, which will be discussed in the second part of this report.

III. What Congress Should Do to Help Consumers, Businesses and Insurers

CFA supported the House terrorism insurance approach (H.R. 3210) that passed the Financial Services Committee[37]. CFA commended the committee members for their work on the bill, particularly Chair Oxley, Subcommittee Chair Baker and Ranking Member LaFalce.

CFA testified that, while we were unsure what would happen if Congress did not act to provide back-up for terror coverage, we thought that the potential consequences were "…severe enough that Congress should worry…"[38]

There is now some experience with the marketplace after January 1st of this year, when 70% of reinsurance contracts came up for renewal. Contrary to some of the predictions that were made about what would happen if federal backup was not in place, the "sky did not fall." The private sector seems to be adjusting to the reality of the hard market and some unavailability of terrorism coverage.

Here is what CFA recommends that Congress do now:

A. Don't Rush Into Passing a Back-Up Bill

Congress has ordered the General Accounting Office (GAO) to review the insurance market and determine if there is a problem. This is an excellent first step.

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[37] CFA opposed the version that passed the full House because of draconian liability restrictions that were added on the Floor.
[38] Testimony of CFA Director of Insurance J. Robert Hunter, at Senate Commerce Committee Hearing of October 24, 2001.

It would also be a good idea to hold hearings, not only to examine market conditions, but also to look into private alternatives to federal back-up.

B. No Handouts are Warranted

If one thing is clear, it is that Congress should not do a taxpayer-funded bailout of this super-rich industry. If any federal back-up is required, it should be a loan program modeled after the House bill, not a give away program that does not require assistance to be paid back.

C. Create Incentives for the Development Of Private Sector Alternatives

Instead of spending a lot of time working on what appears likely to be an unnecessary taxpayer back-up of the insurance companies, Congress should provide incentives for the creation of the fast-developing private alternatives to the over-priced insurance in today's market. Consideration should be given to such ideas as:

- Expanding the Liability Risk Retention Act to cover property insurance.
- Determining if there are any tax disincentives for the development of captive insurance or self-insurance mechanisms.
- Developing proposals to encourage the securitization of risk.

Congress has created incentives for private sector alternatives before, with the Risk Retention Act (RRA). The Product Liability Risk Retention Act of 1981 was developed by Congress as a direct result of the product liability insurance hard market of the mid-1979s. The current version of the Act, the Liability Risk Retention Act of 1986,[39] was passed to expand the Act to all commercial liability coverages as a direct reaction to the hard market of the mid-1980s. It allowed businesses to join together to form purchasing groups to buy liability insurance as a unit or to form self-insurance combinations by getting approved in only one state.

The NAIC describes the RRA as follows:

> The purpose of the RRA is to increase the availability of commercial liability insurance which became severely restricted in the market crisis of the mid-1980s…An RRG[40] is a risk-bearing entity that must be chartered and licensed as an insurance company in one state…Once the group has obtained a license, it may operate in all states…and is regulated almost exclusively by the domiciliary commissioner…The RRA requires that the RRG be owned by its insureds and requires the insureds to have similar or related liability exposure. The only type of coverage an RRG is permitted to write is commercial liability insurance for its members and reinsurance with respect to the liability of

[39] 15 USC §3901 et sec.

[40] RRG is a Risk Retention Group operating under the RRA, the Risk Retention Act.

any other RRG…A PG[41] may purchase only commercial liability insurance for its members…[42]

CFA believes that the creation and expansion of the RRA helped to overcome the problems of the two previous hard markets and would do so again in the current hard market. Not only would expansion of the Act enable small and mid-sized businesses to get together to cover other risks, the alternative puts pressure on the insurance industry to stop price gouging now underway or risk market share.

CFA calls on Congress to expand the RRA to cover all lines of property/casualty insurance, including property and workers' compensation. Consideration should be given to expanding the Act to cover group life and group health contracts…since many businesses getting together would eliminate the aggregation problem in these lines of insurance.

Finally, the hearings on expanding the RRA should also consider the creation of a personal lines version of the Act because, even though the terrorist problem is not severe in personal lines, there are obstacles to the use of efficient group sales of home and auto insurance that RRA would overcome.

D. Address Rate Gouging in any Bill that Passes

If a back-up bill is considered, the bill must adequately address the problem of the price of insurance. It would be foolish to pass a back-up bill and not assure that insurance rates are rolled back to reflect the reduced level of insurer risk that would occur from the creation of the federal back-up.

Hearings held on terror insurance legislation should include consideration of:

- Requiring rate reductions equivalent to the amount of back-up provided. For example, if terrorism coverage is 10% of the rate increase, and the taxpayer is backing up 90% of that subject to later pay back, the premium increase should be rolled back by 9%.
- Requiring states to certify that rates are not excessive. Certainly, any bill that is considered should not prohibit pre-approval of rates, as one Senate draft contemplated.
- Requiring a terror insurance line item on the bill. It is very important that businesses can see the price differences for terrorism and other coverages. This would allow business to determine if other coverages are being unduly hiked vis-à-vis the businesses' claims experience.

IV. What the States Should Do to Help Consumers, Businesses and Insurers

A. Reject Exclusions for Personal Lines of Coverage

[41] PG is a Purchasing Group.
[42] Risk Retention and Purchasing Group Handbook, NAIC, 1999, Pages I1-I3.

Personal lines were never seriously raised as a problem in the debate in Congress about terrorism legislation before January 1, 2002. This is because it is not a problem. There are millions of units of exposure with excellent spread of the risk throughout the nation. Moreover, it is unlikely that terrorists are going to target homes and cars in a way that would trigger an individual's umbrella coverage. At most, damage to homes would be "collateral damage" in an attack on a government building or large commercial facility should another terrorist event occur.

The insurance industry has acted in bad faith by failing to actively advocate for personal lines of coverage to be included in terrorism legislation, and then waiting until Congress adjourned before asking state regulators to allow them to exclude terror coverage from personal lines. CFA has asked the states not to approve terrorism exclusions for personal lines and, if they do, to explain to Congress why the states did not push for federal back-up for personal lines if there was a problem.

B. Reject Exclusions for Commercial Lines for Small and Mid Sized Insureds

For the same reasons as with personal lines, approximately 41 states should not have approved exclusions for terrorism for small and mid-sized businesses. Insurers can spread risk broadly and therefore should be able to make coverage available at reasonable prices. They should roll back these exclusions and limit them to very large commercial businesses, the likely targets of terrorism.

New York and California are to be applauded for disapproving the broad terrorism exclusions. Their refusal to allow exclusions to be applied generally in the commercial property-casualty market will not prevent insurers from removing terrorism coverage from the policies of large commercial companies, particularly "jumbo risks" that are possible terrorist targets. Insurance for these larger commercial risks are individually negotiated in what are known as 'manuscript' policies. CFA knows of no state law that mandates terror coverage for these individually crafted insurance policies.

As mentioned above, larger commercial risks also have methods other than traditional insurance to cover terrorism, such as self-insurance, the creation of captive insurers and the non-admitted market. These options are not generally available to smaller commercial risks, unless the RRA is so expanded as CFA has recommended.

C. Require the Cost of Terror Insurance Coverage as a Line Item on The Bill

(See discussion under federal proposals, above.) The states could do this now under their current authority, even without Congressional action.

D. Review Pricing in the Marketplace, to Prevent Price Gouging, Particularly for the Non-Terror Part of Rates for Smaller and Mid Sized Commercial Insureds

The actuarial considerations are well known for these coverages. There is no reason why the states should not step into the current non-competitive market and assure the business insurance consumers of their states that the rates meet the "not excessive" requirements of state statute. The states should undertake rigorous analyses of ratemaking methods and rate filings and make sure such an analysis is available to the public.

E. Reject the Model Commercial Lines Deregulation Bill Now Before the NAIC for Approval in March, or at Least Delay it Until Price Gouging is Not Present in the Market.

The states need to assure the buyers of business insurance that they are doing their job to protect them. Consider this account of the current market:

> "Paul Buckley, treasury director-risk management at Murray Hill, N.J.-based Lucent Technologies Inc., was furious with one of Lucent's former insurers.
>
> "The Hartford Specialty division of The Hartford Financial Services Group Inc. profited for five years while writing the unique basket aggregate reinsurance for Lucent's Vermont-based captive, First Beacon Insurance Co., Mr. Buckley said. The insurer had collected close to $1.8 million in premiums over the years it wrote the coverage and never came close to being hit with a loss, he noted.
>
> "But on Sept. 5, even before the terrorist attacks changed the insurance market landscape, Hartford sought a nearly fourfold premium increase. The hike was necessary because of the economic turmoil that telecommunications companies face, a Hartford spokeswoman said.
>
> "Then, days before the policy's Oct. 1 renewal, Hartford rescinded its renewal offer.
>
> "'We absolutely became unglued over that,' Mr. Buckley said."[43]
>
> Subsequently, Hartford offered to extend the coverage for 60 days for a prorated threefold premium increase. Mr. Buckley characterized that quote as "ridiculous and unconscionable."

Certainly, with this sort of gouging occurring in the market even for large risks, now is not the time to be deregulating commercial lines. The NAIC should table or reject this Model Bill.

[43] "Risk managers placing blame on insurers for renewal woes." BRADFORD and LENCKUS, National Underwriter Jan. 14, 2002

APPENDIX A: STOCK PRICE CHANGE OF TOP COMMERICAL INSURANCE COMPANIES FROM SEPRTMBER 10TH TO TODAY

	Commercial Writer	Stock Price on 9/10	Stock Price Now (Close1/18)
#1	AIG	$74.26	$79.50
#2	Zurich	25.40	23.10
#3	Travelers (Citicorp)	42.45	49.96
#4	CNA	27.69	28.04
#5	Liberty Mutual	NA	NA
#6	St. Paul	41.25	40.45
#7	Chubb	66.47	66.70
#1 BROKER	Marsh & McLennan	$87.00	$103.37*

- The average increase for the above insurance firms since 9/10: 2.6%.
- A 2.6% return over four months is an annual return rate of 7.8%.

** Increase for Marsh & McLennan, the largest commercial insurance agent/broker: +18.8%.*